

STATE OF ALABAMA
DEPARTMENT OF INSURANCE

REPORT ON EXAMINATION

AS OF

DECEMBER 31, 2005

OF

SOUTHLAND NATIONAL INSURANCE CORPORATION

Participation:
Alabama
Southeastern Zone, NAIC

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AFFIDAVIT

STATE OF ALABAMA
COUNTY OF TUSCALOOSA

Blase Francis Abreo, being first duly sworn, upon his oath deposes and says:

THAT he is an examiner appointed by the Commissioner of Insurance for the State of Alabama;

THAT an examination was made of the affairs and financial condition of *SOUTHLAND NATIONAL INSURANCE CORPORATION*, for the period of January 1, 2002 through December 31, 2005;

THAT the following 56 pages constitute the report therein to the Commissioner of Insurance of the State of Alabama; and

THAT the statements, exhibits, and data therein contained are true and correct to the best of his knowledge and belief.

Francis Blase Abreo
Blase Francis Abreo, CFE

Subscribed and sworn to before the undersigned authority this 6th day of April 2007.

Rynda R. Holt
(Signature of Notary Public)

Lynda A. Holt Notary Public
(Print Name)

in and for the State of Alabama

My Commission expires NOTARY PUBLIC STATE OF ALABAMA AT LARGE
MY COMMISSION EXPIRES: July 26, 2008
BONDED THROUGH NOTARY PUBLIC UNDERWRITERS



Bob Riley
GOVERNOR

STATE OF ALABAMA
DEPARTMENT OF INSURANCE
FINANCIAL/EXAMINATION DIVISION

201 Monroe Street, Suite 1700
Post Office Box 303351
Montgomery, Alabama 36130-3351
Telephone: (334) 241-4151
Facsimile: (334) 240-3194

WALTER A. BELL
COMMISSIONER

CHIEF EXAMINER
RICHARD FORD

STATE FIRE MARSHALL
JOHN S. ROBISON

INTERIM GENERAL
COUNSEL
TERRY RAYCRAFT

RECEIVER
DENISE B. AZAR

PRODUCER LICENSING
MANAGER
JIMMY W. GUNN

Tuscaloosa, Alabama
April 6, 2007

Honorable Mary Jo Hudson, Director
Chairman of Examination Oversight
Ohio Department of Insurance
2100 Stella Court
Columbus, Ohio 43215-1067

Honorable Julie McPeak, Executive Director
Southeastern Zone Secretary
Kentucky Office of Insurance
Post Office Box 517
Frankfort, Kentucky 40602-0517

Honorable Merle Scheiber, Director
Midwestern Zone Secretary
South Dakota Division of Insurance
Department of Revenue and Regulation
445 East Capitol Avenue, 1st Floor

Honorable Kent Michie, Commissioner
Western Zone Secretary
Utah Department of Insurance
3110 State Office Building
Salt Lake City, Utah 84114-1201

Honorable Walter Bell, Commissioner
Alabama Department of Insurance
201 Monroe Street, Suite 1700
Montgomery, Alabama 36104

Dear Commissioners and Directors:

Pursuant to your instructions and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners, a full scope financial and market conduct examination as of December 31, 2005, has been made of

SOUTHLAND NATIONAL INSURANCE CORPORATION

at its home office at 1812 University Boulevard, Tuscaloosa, Alabama, 35401. The report of examination is submitted herewith. Where the description "Company" or SNIC appears herein, without qualification, it will be understood to indicate Southland National Insurance Corporation.

SCOPE OF EXAMINATION

A full scope financial and market conduct examination was authorized pursuant to the instructions of the Alabama Insurance Commissioner and in accordance with the statutory requirements of the *Alabama Insurance Code* and the regulations and bulletins of the State of Alabama Department of Insurance in accordance with the applicable guidelines and procedures promulgated by the National Association of Insurance Commissioners (NAIC); and in accordance with generally accepted examination standards.

The Company was last examined for the five-year period ended December 31, 2001. The current examination covers the intervening period from January 1, 2002, through December 31, 2005, and was conducted by examiners from the Alabama Department of Insurance. Where deemed appropriate, transactions subsequent to December 31, 2005, were reviewed.

The examination included a general review of the Company's operations, administrative practices, and compliance with statutes and regulations. Corporate records were inspected. Income and disbursement items for selected periods were tested. Assets were verified and valued, and all known liabilities were established or estimated as of December 31, 2005. However, the discussion of assets and liabilities contained in this report has been confined to those items which resulted in a change to the financial statements, or which indicated a violation of the *Alabama Insurance Code* and the Insurance Department's rules and regulations, or other insurance laws or rules, or which were deemed by the examiner to require comments and/or recommendations.

Company office copies of the filed Annual Statements for the years 2002 through 2005 were compared with or reconciled to account balances with respect to ledger items.

The market conduct phase of the examination consisted of a review of the Company's territory, plan of operation, complaint handling, marketing and sales, producer licensing, policyholder service, underwriting and rating, claims payments and practices, compliance with insurable interest statute, and privacy policies and practices.

A signed certificate of representation was obtained during the course of the examination. In this certificate, management attests to have valid title to all assets and to the nonexistence of unrecorded liabilities as of December 31, 2005. A signed

letter of representation was also obtained at the conclusion of the examination whereby management represented that, through the date of this examination report, complete disclosure was made to the examiners regarding asset and liability valuation, the financial position of the Company, and contingent liabilities.

ORGANIZATION AND HISTORY

Since the Company is a product of a merger between two Alabama domestic insurers, a brief history of each is related as follows:

Southland National Insurance Corporation (SNIC):

SNIC had its origins in 1950, as an Alabama mutual aid association under the name, Southland National Insurance Company (Old Southland). In 1964, Old Southland was acquired by Lecil Dean Gray, who sold its existing book of small health and accident policies. Mr. Gray then commenced the sale of the "Founders Policy," a \$500 life policy that was participating and convertible at the end of six years into a whole life policy. Founders Policies were sold in conjunction with a dividend trust and stock procurement agreement, whereby trust accumulations, dividends and contributions, were used to capitalize a legal reserve life insurance corporation.

On January 21, 1969, the trust principle (which was then in excess of \$500,000) was contributed to a newly formed legal reserve life insurance corporation, New Southland National Insurance Company (New Southland). At this time, the Founders Policies became convertible to participating whole life policies, and the amounts of dividends accumulated were exchangeable for an equivalent amount of New Southland common stock, in accordance with the dividend trust and stock procurement agreement. All of the assets and liabilities of Old Southland were transferred to New Southland. The original capital stock of New Southland consisted of 239,559 common shares, par value \$1.00, issued and outstanding.

On April 5, 1971, New Southland's authorized capital stock was increased from 400,000 shares to 5,000,000 shares; par value remained \$1.00 per share.

On May 27 1988, New Southland's Articles of Incorporation were amended to change its name to Southland National Insurance Corporation (SNIC).

On June 5, 1992, a one-for-four reverse stock split was affected on SNIC's common stock. The number of authorized shares was thereby reduced to 1,250,000, and the par value was increased from \$1.00 per share to \$4.00 per share.

On May 27, 1994, the par value of SNIC's common stock was increased from \$4.00 to \$6.00, thereby increasing the authorized capital to \$7,500,000. Paid up capital was accordingly increased to \$1,502,718 in respect to the 250,453 shares outstanding. The \$500,906 increase in paid up capital was funded by a transfer from paid in surplus. There were no further changes in the capital stock of SNIC.

Southwide Life Insurance Corp. (Southwide):

Southwide was incorporated on February 14, 1983, under the name, Freedom Life Insurance Company. It was formed as a subsidiary of Collateral Investment Company, an Alabama limited partnership. Subsequently, the name of Collateral Investment Company was changed to Collateral Mortgage Company, Ltd. (CML).

On January 18, 1986, the name Freedom Life Insurance Company was changed to Southwide Life Insurance Corp.

On October 1, 1990, a reorganization of CML resulted in the transfer of 100% of the stock of Southwide to a newly formed holding company, Collateral Investment Corp. (CIC). The stock of CIC was distributed to the partners of CML. At that time, the majority owner of both CML and CIC was William Thomas Ratliff, Jr., so there was no change in the ultimate control of Southwide.

The capital stock of Southwide at the date of the merger consisted of 1,500,000 common shares issued and outstanding, par value \$1.00. Gross paid in and contributed surplus amounted to \$1,000,000.

The Company (subsequent to the merger):

Subsequent to the merger, the Company survived under the name and charter of Southland National Insurance Corporation, but under the ownership and control that formerly applied to Southwide. The Company's capital stock as of December 31, 2005 amounted to \$1,502,718, consisting of 1,250,000 common shares authorized, par value \$6.00, of which 250,453 were issued and outstanding. Gross paid in and contributed surplus amounted to \$5,528,042.

MANAGEMENT AND CONTROL

Stockholder

The Company was incorporated under the laws of the State of Alabama and is deemed to be subject to the Alabama Business Corporation Act as defined in ALA. CODE § 10-2B-1-01(1975), which states:

"(a) This chapter shall be known and may be cited as the "Alabama Business Corporation Act." (b) Without in any way limiting the generality of any provisions of this chapter, all of the provisions of this chapter shall apply to banks, trust companies, savings and loan associations, insurance companies..."

The examiner requested the copy of the stock certificate issued by the Company to its sole stockholder "Collateral Mortgage, Ltd." Company management stated:

"A document in the form of a certificate was not issued to the Sole Shareholder."

Since a stock certificate was not issued to the stockholder, the Company did not comply with ALA. CODE § 10-2B-6.25(1975), which states:

"(a) Shares shall be represented by certificates. (b) At a minimum each share certificate must state on its face: (1) The name of the issuing corporation and that it is organized under the law of this state; (2) The name of the person to whom issued; and (3) The number and class of shares and the designation of the series, if any, the certificate represents..."

At December 31, 2005, one hundred percent of the Company's issued and outstanding common stock was owned by Collateral Mortgage, Ltd., an Alabama limited partnership. The ultimate control is vested in the hands of Mr. William T. Ratliff, III and Mr. William T. Ratliff, Jr.

The Company's corporate records were reviewed during the period covered by the examination. The examiners were not provided with the minutes of the stockholders meetings for 2005. The Company did not comply with ARTICLE I, Section 2, of the By-Laws, which states:

"The Annual Meeting of the stockholders of said Company shall be held at Tuscaloosa, Alabama, on a date to be set by the Board of Directors each year for the purpose of electing Directors and receiving reports from the old Board and officers..."

ALA. CODE § 27-27-23(1975), which states:

"Directors must be elected by the member or stockholders of a domestic insurer at the annual meeting of stockholders or members..."

ALA. CODE § 10-2B-7.01(a) (1975) states:

"A corporation shall hold a meeting of shareholders annually at a time stated or fixed in accordance with the bylaws."

Board of Directors

The *By-Laws* of the Company provided that the business and affairs of the Corporation shall be managed by its Board of Directors. ARTICLE II, Section 1 of the amended *By-Laws* set the number of directors at "... not fewer than five in number, nor more than twenty, who shall be elected annually by the stockholders at their regular annual meeting..."

Directors serving at December 31, 2005, were as follows:

<u>Name and Residence</u>	<u>Principal Occupation</u>
William Harrison Lanford Tuscaloosa, Alabama	Retired President of the Company
Roger Dale Murphree Birmingham, Alabama	Sr. VP & COO of New South Federal Saving Bank
Lizabeth Reynolds Nichols Birmingham, Alabama	General Counsel of New South Federal Saving Bank
Robert Williamson Jennings, Jr. Birmingham, Alabama	CEO & President of Collateral Holding, Ltd.
Brian Richard Herrick* Birmingham, Alabama	President of the Company

*Resigned on April 10, 2006.

The review of the minutes of the Board of Directors meeting indicated that the investment transactions during the period covered by the examination were not authorized, approved or ratified by the Board of Directors as required by ALA CODE § 27-41-5, which states:

"An insurer shall not make any investment or loan, other than loans on policies or annuity contracts, unless the same be authorized, approved or ratified by the board of directors of the insurer or by such committee or person as the board of directors shall expressly authorize. The action of the

board of directors, the committee or other persons so authorized shall be recorded and regular reports thereof shall be submitted to the board of directors..."

A review of Company's corporate records, including the Company's minutes of the Shareholders and Board of Directors meetings, indicated that the capital contributions made by Collateral Investment Corporation during the years 2003 and 2004 were not recorded in the minutes of the Shareholders and Board of Directors meetings. The Company did not comply with ALA. CODE § 10-2B-16.01(1975), which states:

"A corporation shall keep as permanent records minutes of all meetings of its shareholders and board of directors, a record of all actions taken by the shareholders or board of directors without a meeting, and a record of all actions taken by a committee of the board of directors in place of the board of directors on behalf of the corporation."

Officers

Officers of the Company elected by the Board of Directors on April 5, 2005 and serving at December 31, 2005, were as follows:

Officer	Title
Robert Williamson Jennings, Jr.	CEO & Chairman
Brian Richard Herrick*	President & General Counsel
Celice Nicole Horsak	Secretary
Robert Anthony Rinaldi*	CFO & Treasurer
Joseph Arthur May, Jr.	Chief Operating Officer & Executive Vice President
Robert Hugh Rust	President, Southland Benefit Administrators
James Edward Leitner, Sr.	Vice President of Operations – Supplemental Benefits
Julian Bentley Person	Vice President of Information System

*Resigned in 2006.

Committees

No committees of the Board of Directors were appointed during the examination period.

Conflict of Interest

The Company follows an established procedure for the disclosure of conflicts between the Company's interest and personal interest of directors and officers. The conflict of interest statements filed, annually, by the officers and directors of the Company were reviewed for the period covered by the examination.

The examiner established that some of the officers of the Company did not complete the conflict of interest statements, which was not in compliance with the Company's conflict of Interest Policy and GENERAL INTERROGATORIES of the NAIC Annual Statement Instructions, which asks the following questions:

“Has the reporting entity an established procedure for disclosure to its board of directors or trustees of any material interest or affiliation on the part of any of its officer, directors, trustees, or responsible employees that is in conflict or is likely to conflict with the official duties of such persons?”

CORPORATE RECORDS

The Articles of Incorporation, and By-Laws, as amended were inspected and found to provide for the operation of the Company in accordance with usual corporate and applicable statutes and regulations. One amendment was made to the By-Laws during the period covered by the examination.

Minutes of the meetings of shareholders, and Board of Directors were reviewed for the period covered under the examination. Other than the items previously noted in the caption MANAGEMENT AND CONTROL, the minutes appeared to be complete with regard to recorded actions taken on matters before the respective bodies for deliberation and action.

HOLDING COMPANY AND AFFILIATES

Holding Company Registration and Reporting

The Company is subject to the *Alabama Insurance Holding Company Regulatory Act*, as defined in ALA. CODE § 27-29-1 (1975). In connection therewith, the Company is registered with the Alabama Department of Insurance as joint registrant of an Insurance Holding Company System. The Company is responsible for holding company registration and periodic filings in accordance with ALA. CODE § 27-29-4 (1975), and ALA. ADMIN. CODE 482-1-055(1994).

Holding company filings and amendments made on behalf of the Company, from December 31, 2001 through July 25, 2006 were reviewed. The Company did not provide evidence that the Alabama Department of Insurance approved the following agreements with affiliated groups:

1. Administrative Services Agreement with Collateral Benefit Group
2. Investment Advisory Agreement with Collateral Mortgage, Ltd.
3. Mortgage Servicing Agreement with Collateral Mortgage
4. Mortgage Servicing Agreement with First Mortgage Co. (Wells Fargo.)
5. Administrative Services Agreements with the following subsidiaries:
 - Southland National Trust Company Inc.
 - Southland National Funeral Group, Inc.
 - Benefit Resources Group LLC
6. Tax Sharing Agreement

Since the Company did not obtain approval of the agreements with affiliated groups, the Company was not in compliance with ALA. CODE § 27-29-5(b) (1975), which states:

“The following transactions involving a domestic insurer and any persons in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such transaction at least 30 days prior thereto...

(4) All management agreements, services contracts, and all cost sharing arrangements.”

The Company acknowledged that the aforementioned agreements were not filed with the Alabama Department of Insurance. The previous examination had also established that the related party agreements, under which the related parties' transactions were taking place, were not filed with the Alabama Department of Insurance.

Company management indicated that new agreements between affiliated groups would be filed with the Alabama Department of Insurance.

Dividends to Stockholders

The Company paid stock dividend to Collateral Investment Corporation (CIC) in the amount of \$111,000 in 2003. CIC received all the shares and control of Benefit Resources Group LLC.

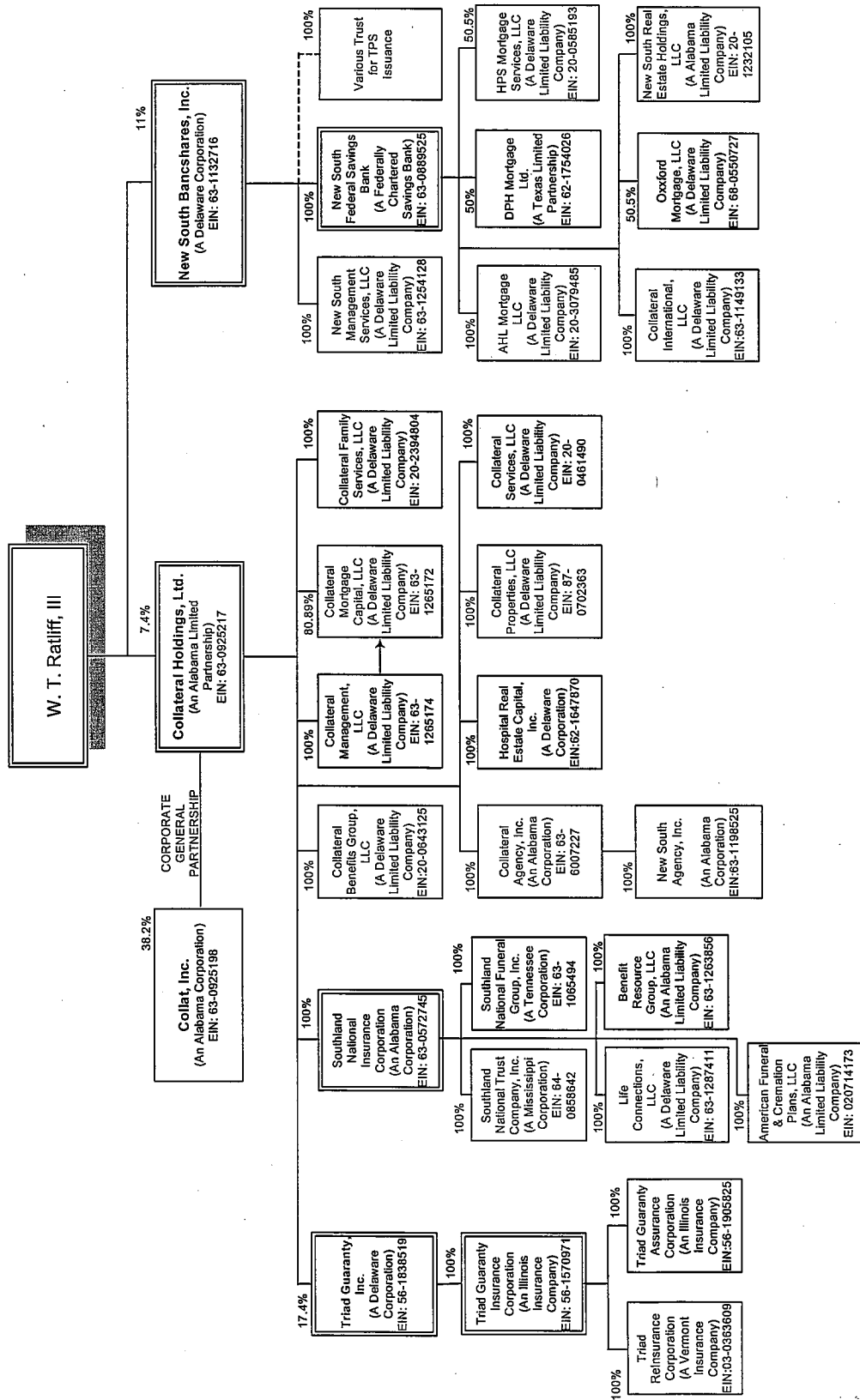
The Company did not report the payment of dividend to the Alabama Department of Insurance through a Form B filing, which was in violation of ALA. CODE § 27-29-5 (g) (2)(1975), which states:

"A domestic insurer subject to registration under Section 27-29-4 shall report to the commissioner all dividends to shareholders within five business days following the declaration of the dividends and not less than 10 days prior to the payment of the dividends. This report shall also include a schedule setting forth all dividends or other distributions made within the previous 12 months."

Organization Chart:

The following Chart presents the identities and interrelationships among all affiliated persons within the Insurance Holding Company System at December 31, 2005.

COLLATERAL FAMILY OF COMPANIES (Post CIC/Triad Transaction)



Agreements with Affiliates

At December 31, 2005, the Company had the following agreements with affiliates:

Agreement for Administrative Services:

The Company entered into an Administrative Services agreement with Collateral Benefits Group, Inc. (CBG), effective December 1, 2002. CBG is an insurance agency licensed as an insurance agency by the Alabama Department of Insurance. CBG agreed to provide management and administrative services, including consultation on insurance and benefits products, or provide services and processes on an as needed basis. The cost of services provided by CBG would be billed on an hourly rate or fees mutually agreed, by the parties to the agreement, based on the services, hours worked, experience and costs of the resources utilized.

The agreement will be renewed, automatically, on each anniversary date for a period of twelve months after the initial twelve months contract term. Either party to the contract can terminate the agreement by providing a written notice of at least sixty days.

Investment Advisory Agreement:

The investment advisory agreement, dated January 1, 1997 was in effect between the Company and Collateral Mortgage, Ltd. (CML). This agreement provides how CML is to manage the Company's securities investments, in accordance with the Company's procedures, objectives, limitation and restrictions. Either party to the contract can terminate the agreement by providing a written notice of at least sixty days.

The investment advisory fees are paid quarterly and the asset categories for calculating fees are bonds, notes, common and preferred stocks. For fixed maturity securities, a graduated rate of 0.20% per annum of the first \$20 million, and 0.12% per annum of the excess over \$20 million. The fees for common and preferred stocks are calculated at the rate of 0.250% per annum of the lower of cost or market.

Mortgage Servicing Agreement:

This agreement, dated December 31, 1986, was between Southwide Life Insurance Corporation (Southwide) and Collateral Mortgage, Ltd (CML). The agreement has continued with the Company, uninterrupted by the merge even though no

assumption agreement was signed by the Company to assume all rights and obligations from Southwide. The agreement provides the terms under which the Company may purchase mortgage loans from CML; and, provides for CML's continuing servicing of said mortgage loans for specified fees.

The agreement may be terminated by CML for certain causes or by the Company after sixty days written notice to CML.

Mortgage Servicing Agreement:

The agreement, dated December 31, 1986 was between First Mortgage Company, Inc. and New Southland National Life Insurance Company (Old Southland). The agreement has continued with the Company, uninterrupted by the merge even though no assumption agreement was signed by Wells Fargo Home Mortgage who assumed all rights and obligations for servicing the loans from First Mortgage Company.

The owner may terminate the agreement at any time without cause by giving 35 days notice.

Administrative Services Agreement:

The Company entered into an administrative services agreement, with three affiliated companies: 1) Southland National Funeral Group, Inc., 2) Southland National Trust Company, Inc. and 3) Benefit Resources Group, LLC. This is a cost sharing agreement where actual cost for administrative and support services are shared by the parties to the contract. The following costs are settled monthly:

- a) Only reasonable, customary and usual charges for services rendered by the Company for benefit of its subsidiaries may be shared under the agreement.
- b) Only actual cost (or reasonable estimates thereof) may be shared.
- c) Only costs for services actually rendered or goods actually purchased by SNIC for the direct benefit of its subsidiaries may be shared under the agreement.

The agreement will automatically be renewed for a period of twelve months, unless either party gives the other written notice at least sixty days prior to the end of any term of its intent not to renew the agreement for another term.

Tax Sharing Agreement:

On December 31, 2002, Collateral Investment Corporation, (Holding Company) and eight members of the affiliated group, including the Company, executed a tax allocation agreement. The Company filed consolidated tax return for the years 2002, 2003, 2004 and October 31, 2005. The Company filed an individual tax return for October through December 31, 2005.

FIDELITY BOND AND OTHER INSURANCE

At December 31, 2005, the Company was a named insured under a financial institution bond by Federal Insurance Company. The single loss limit of the bond exceeded the NAIC suggested minimum requirements for fidelity coverage. The bond provided the following coverages:

- Dishonesty (Employee, and Servicing Contractor)
- On Premises
- In Transit
- Forgery or Alteration
- Extended Forgery
- Counterfeit Money
- Computer System

The Federal Insurance Company coverage insured the Company against any loss due to any dishonest or fraudulent act committed by an employee acting alone or in collusion with others. The dishonest or fraudulent acts must be committed by the employee with the intent to cause the insured to sustain such loss and to obtain financial benefit for the employee in the normal course of employment.

EMPLOYEES' AND AGENTS' WELFARE

Employee Benefits

As of December 31, 2005, the Company provided the following benefits to its employees and agents:

- flextime
- paid vacation
- paid sick leave

- paid holidays
- medical appointment leave
- jury duty
- bereavement leave
- family medical leave
- health insurance
- dental insurance
- group life
- 401(k) plan
- employee assistance program
- tuition reimbursement

Section 1033 of Title 18 of the US CODE

The Company was asked how it determined if prospective and current employees and agents were not in conflict with Section 1033 of Title 18 of the US Code and ALA. ADMIN. CODE 482-1-121 (2003), which states:

"Any individual who has been convicted of any criminal felony involving dishonesty or a breach of trust, or who has been convicted of an offence under this section, and who willfully engages in the business of insurance whose activities affect interstate commerce or participates in such business, shall be fined as provided in this title or imprisoned not more than 5 years, or both."

Company management indicated that when the employment applications are processed, the Company runs a criminal background report on all prospective employees. The Company does not hire any applicants who have been convicted of a felony.

All agents appointed by the Company are rigorously screened before any appointment is considered. The Company does not appoint any agent who is unable to comply with the licensing requirements of their state of appointment.

The examination established that the Company had adequate procedures to screen potential employees and update personnel information. Hence, the Company complied with Section 1033 of Title 18 of the US Code and ALA. ADMIN. CODE 482-1-121 (2003).

MARKET CONDUCT ACTIVITIES

Plan of Operations

The Company's primary lines of business are pre-need life insurance products, which are marketed through funeral homes, and group dental products, which are marketed by Collateral Benefit Group, Inc., and sold in the state of Alabama. The Company was licensed in eighteen states at December 31, 2005.

The Company's agency force consists of funeral homes and individual agents, within certain funeral homes. Regional managers are under the direction of the Company's senior vice president of marketing, and are for the recruitment of funeral homes and agents to do business with the Company.

The Company is a third party administrator for the Public Education Employee's Health Insurance Board (PEEHIP). The contract with PEEHIP was renewed in October 2004 for a three-year-term. Under the terms of the contract, the Company administers self-benefit programs for indemnity, vision, dental, and cancer insurance.

Territory

At December 31, 2005, the Company was licensed to transact business in the following states:

Alabama	Florida	Louisiana	Ohio	Texas
Arizona	Georgia	Mississippi	Oklahoma	Virginia
Arkansas	Indiana	New Mexico	South Carolina	
Colorado	Kentucky	North Carolina	Tennessee	

Policy Forms, Rates and Underwriting Practices:

The Company filed the following forms and endorsements with the Alabama Department of Insurance during the period covered by the examination:

- Horizon (Whole Life Insurance),
- Meridian (Group Life Insurance),
- Landmark (Whole Life Insurance), and
- Guaranteed Increasing Benefit (GIB).

The examiners reviewed a sample of policy application files and established that the rates charged for the policy coverage were in accordance with the rating cards and the policy applications. The Company's active policy forms were inspected and found to be approved by the Alabama Department of Insurance.

A sample of fifty policies that had converted to non-forfeiture options was selected to verify that the correct option was granted to the insured. There were twelve policies that converted to a reduced paid-up policy, instead of going to extended term insurance as provided for in the provisions of the policy.

Advertising and Marketing

The Company did not have a formal advertising program as of December 31, 2005. During the examination period, the Company's advertising program was limited to printed sales brochures provided for distribution via its agency force, a website that was accessible by the public, and advertisements included in trade journals.

Compliance with Agents' Licensing Requirements

The examiners reviewed the Company's records to determine that agents representing the Company were properly licensed and appointed by the State of Alabama. The agents' listing from the Alabama Department of Insurance Licensing Division was compared with the listing maintained by the Company. No discrepancies were noted.

The examiner obtained the policy application files for a sample of policies as of December 31, 2005. The examiner determined that agents representing the Company in the state of Alabama were appropriately appointed by the Company and licensed by the State of Alabama to transact business on behalf of the Company at the time the policies were written.

Claims Payment Practices

A sample of 100 items was taken from the paid claims listings for the four years covered by the examination. The claims were all Alabama claims, and they were reviewed for compliance with Alabama Laws and Regulations, and compliance with policy provisions, timeliness of payment, and adequacy of documentation. No significant discrepancies were found.

Privacy Policies and Practices

[Compliance with ALA. ADMIN. CODE 482-1-122 (2002), formerly known as Alabama Department of Insurance Regulation No.122]

The Company's PRIVACY NOTICE, which was first sent as mass mailing to all Company policyholders in May 2001 was reviewed for compliance with ALA. ADMIN CODE 482-1-122 (2002). The privacy notice is mailed to new policyholders and thereafter at the time of renewal of the policies. The privacy notice indicated the types of information collected by the Company, the way it is used, and the manner of collection. The notice also informed the customer that the Company will not disclose any information to any nonaffiliated third parties. Hence, the Company appeared to follow the guidelines established in ALA ADMIN CODE 482-1-122 (2002).

SPECIAL DEPOSITS

In order to comply with the statutory requirements for doing business in the various jurisdictions, in which it was licensed, the Company had the following securities on deposit with state authorities at December 31, 2005.

<u>State</u>	<u>Book Value</u>	<u>Fair Value</u>
Alabama*	\$1,608,755	\$1,740,513
Arkansas	260,309	262,754
Florida	238,026	270,360
Georgia	214,984	214,911
New Mexico	267,772	258,623
North Carolina	522,707	536,585
Ohio	126,337	126,233
Oklahoma	333,947	324,830
South Carolina	251,837	267,445
Virginia	347,450	426,111
Total	\$4,172,124	\$4,428,365

*Held for the protection of all policyholders.

FINANCIAL CONDITION/GROWTH OF THE COMPANY

The following table sets forth the significant items indicating the growth and financial condition of the Company for the period under review:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital and Surplus</u>	<u>Premiums Earned</u>
2005*	\$132,560,232	\$122,394,870	\$10,165,362	\$32,537,662
2004	124,692,823	115,253,819	9,439,004	37,999,775
2003	104,442,605	95,792,604	8,650,001	34,348,465
2002	82,282,226	75,087,865	7,194,361	21,967,969
2001*	71,464,210	63,910,872	7,553,338	15,331,039

*Per examination. Amounts for the remaining years were obtained from Company copies of filed Annual Statements.

MORTALITY AND LOSS EXPERIENCE

The information was obtained from the Company's filed Annual Statement for the years 2005, 2004, 2003 and 2002:

<u>Year</u>	<u>Tabular cost</u>	<u>Contract Benefits</u>	<u>Reserves Released by Death</u>
2005	13,365,988	16,175,473	7,234,957
2004	4,372,662	15,228,178	6,177,380
2003	5,443,299	11,582,675	6,230,519
2002	9,863,264	9,286,500	4,464,113

It should be noted that the tabular cost plus reserves released by death was greater than the contract benefits (except for 2004), which implies that the mortality costs built into the reserves are sufficient to cover the contract benefits of the company.

The percentage of contract benefits when compared to the insurance in force during those four years ranged from 36% to 70%. This also implies that the Company's mortality costs are sufficiently covered. It should be noted that the Company writes pre-need funeral and cemetery coverage. This is coverage, which is normally purchased by insureds that are older in age than would normally be expected in an insurance company. Since mortality costs increase by attained age and there is very little underwriting in the pre-need business, the Company has higher mortality costs than many insurance companies, but at the same time, charges a much higher premium for the face amount of coverage.

REINSURANCE

Assumed

Schedule S – Part 1 – Section 2 of the Company's 2005 Annual Statement indicated that the Company assumed reinsurance under the following reinsurance agreement:

The 100% quota share reinsurance agreement with US Able Life Insurance Company was managed by American Pre-Arrangement Services Inc., a third party administrator, of the Company. It was established that the Company did not audit the records maintained by American Pre-Arrangement Services Inc., on underwriting of new contracts, premium receipts, and claims settlement. Hence, there was no documentation to verify the accuracy of the information provided by the Company, which was not in compliance with ALA. CODE § 27-27-29(a)(1975), which states:

“Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its asset, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind or kinds, of insurance transacted.”

At December 31, 2005, a 100% assumed coinsurance contract, with US Able Life Insurance Company was in-force with an effective date of July 22, 2002. According to a fronting fees reimbursement schedule, effective January 1, 2005, the Company was to pay a fronting fee of \$2 per contract to US Able. The examiner reviewed the fronting fees reimbursement records provided by Company management and determined that the fees were calculated at the rate of 10.5% per contract or \$2.205 per contract, which was \$0.205 more than the \$2 negotiated in the contract. In addition, even though not specified in any of the agreements provided, the Company paid an additional 2.5% of premiums to US Able for reimbursement of premium taxes. Hence, it was established that the Company did not comply with the terms of the reinsurance agreement.

The coinsurance agreement also specified that the Company shall issue a letter of credit to US Able in an amount equal to the quota share percentage of the statutory reserves on the business reinsurance as of December 31, 2002. This letter of credit shall remain in place for so long as this agreement remains in effect. Within 45 days following January 1 of each year in which this Agreement remains in effect, US Able and the Company shall agree to a change in the amount of the Letter of Credit corresponding to the change in the statutory reserves on the policies covered by this agreement. The letter of credit shall automatically terminate on the date this

agreement terminates. The Company maintains that they have not issued a letter of credit.

The in-force listing for the return of mortal remains plan provided by the Company was obtained from American Pre-Arrangement Service Inc., a third party administrator of the contracts. The examiners utilized ACL and the in-force listing, and established that 49,974 contracts were in-force as of the examination date. According to the terms of the contract, the Company was required to record reserves equal to 100% of statutory reserves. The Company booked *Aggregate reserve for accident and health contracts* based on 48,435 contracts, which was 1,539 contracts less than that determined by the examination. See *Note 9 - Aggregate reserve for accident and health contracts* under the caption NOTES TO FINANCIAL STATEMENTS for further discussion.

Michael Tucker, FSA, MAAA with Wakely Actuarial Services, Inc. prepared the coinsurance agreement relating to this fronting arrangement. Wakely Actuarial Services, Inc. prepared and submitted the group global accident and sickness policy with the State of Alabama, on behalf of US Able. Examiners were unable to determine why this form was filed in Alabama because the filing indicated that only one policy was going to be issued to American Pre-Arrangements Services, Inc., which appears to be incorporated in California. Michael Tucker signed the actuarial opinions for Southland National Insurance Corporation during the period covered by this examination. In addition, the Company has a coinsurance agreement, discussed under the next caption with Southern Financial Life Insurance Company, a related party to Wakely Actuarial Services, Inc.

In addition to the coinsurance fronting agreement, there was at least one memorandum of understanding, with various amendments, some partially executed and some not executed at all. The memo of understanding was actually dated after the executed reinsurance agreement. The memo of understanding contains elements that were significantly different than the coinsurance agreement, including "The Company and APASI agree to execute a side letter of agreement that details the partial transfer of the ultimate claims paid by the Company to APASI, should claims exceed a mutually agreed claims threshold. Conversely, should claims complete at a level lower than expected a reward arrangement shall engage."

As of January 31, 2007, American Pre-Arrangement Services, Inc. (APASI) indicates that Southland was reinsuring 70,447 contracts. In addition, Mr. Maurice J. Brashaw, President of APASI, indicated that "The contract is a transportation services contract and not an insurance contract. We clearly state on each contract that services must be preformed (sic) by APASI; no claims for reimbursement will be accepted. The purchaser takes constructive receipt of the product at the time of purchase. The

effective date of the contract is the date that the purchaser pays for the product.” He goes on to say that the product is marketed to “clients” via “signed contracts with independent funeral homes, cemeteries, funeral home consolidators, insurance companies, etc. They do not have members, they have clients. The only company marketing the product is APASI.” The group contract that was filed with the State of Alabama indicated that eligible persons were “all participants in TAP (Travel Assistance Program.) The information provided to the examiners did not include a certificate. In addition, there was no evidence that any “members” ever received certificates.

At the request of the Alabama Department of Insurance, the Company indicated that they would immediately send a termination notice to US Able regarding future business. In addition, the Company was instructed to obtain an accurate in-force listing of all individuals insured under this arrangement, including information on their residence. Company management indicated that they will require copies of death certificates, which should include place of death.

The examiners expressed concern regarding how the in-force listing will be maintained and how reserves will develop and be released on this block of business. Currently, there is no formal mechanism in place to determine if insureds have died but did not have a claim under this program.

At the date of this examination report, the Alabama Department of Insurance had not required retroactive cancellation of this contract; however, this issue is unresolved.

Ceded

Schedule S – Part 3 – Section 1 of the 2005 Annual Statement indicated that the Company’s ceded program encompassed agreements with five reinsurers. However, 100% of the reserve credit taken by the Company was on the reinsurance contracts with the following reinsurers:

Hannover Life Reassurance Co. of America (Hannover)

Type	50% Automatic Quota Share Coinsurance Agreement
Coverage	1) Virginia Meridian (Home Team) Series, 2) Virginia Horizon (TPM) Series, 3) Meridian Series, 4) Horizon Series, and 5) Landmark Series.
Effective	September 1, 2005
Insolvency	Standard insolvency language without cut-through provisions included under ARTICLE VII – General Provisions

Southern Financial Life Insurance Company (SFLIC)

Type	100% Coinsurance Agreement
Coverage	Traditional Life, Final Expenses and some Annuities
Effective	September 30, 2005
Insolvency	Standard insolvency language without cut-through provision
Other Information	SFLIC was not a licensed or approved reinsurer in the State of Alabama. The Trust Agreement dated September 28, 2005, indicated that the Company was the beneficiary in the trust.

The reinsurance agreements with 1) Hannover, and 2) SFLIC entered into during the examination were established to be coinsurance agreements. In *Schedule S - Part 3 - Section 1*, the Company utilized the abbreviation YRT/I (yearly renewable term) instead of CO/I. Company management agreed that there was an error in reporting the "Type" of reinsurance ceded and the appropriate "Type" was CO/I. The Company should comply with the guidance provided by the NAIC Annual Statement Instructions when abbreviations are used to identify the plan and type of reinsurance in *Schedule S - Part 3 - Section 1*, which states:

"Column 6 - Type - Use the following abbreviations to identify the plan and type of reinsurance. For example, group coinsurance with funds withheld should be identified as COFW/G (If there is more than one type of reinsurance in the same reinsurance company, show each type on a separate line.) The type should be entered in all capital letters, and ALL reinsurance type should be followed by /G (for Group) or/I (for Individuals... Abbreviations: Individuals - I; Group - G; Catastrophe - CAT; Yearly renewable term - YRT; Coinsurance - CO..."

The examiners established that the Company did not maintain underwriting files for the reinsurance contracts with Hannover and SFLIC Company. The reinsurance underwriting file should include the appropriate records such as a) historical loss ratios and combined ratios of ceding companies, b) anticipated loss ratios under contract, c) indications of the content and frequency of ceding company reports, d) prior business experience with ceding company, e) the assuming company's past experience with similar risks, f) pricing and ceding commission information. Since the Company did not maintain the underwriting files, the Company was not in compliance with ALA. CODE § 27-27-29(a)(1975), which states:

"Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and

systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

ACCOUNTS AND RECORDS

The Company's principal accounting records were maintained on electronic data processing equipment.

The Company was audited annually by the independent certified public accounting (CPA) firm of PriceWaterHouseCoopers, Birmingham, Alabama in 2002 and was audited by KPMG, Birmingham, Alabama, in 2003 and 2005. The Company's reserves for the year 2002 - 2005 were certified by Wakely Actuarial Services, Inc.

Accounting records

The examiner reviewed a sample of thirty-two cash disbursements, and determined that the Company could not provide check vouchers for seven of the disbursements, and because of this was not in compliance with ALA CODE § 27-27-30 (1975), which states:

"No insurer shall make any disbursement of \$25.00 or more unless evidenced by a voucher or other document correctly describing the consideration for the payment and support by a check or receipts or receipt endorsed or signed by, or on behalf of, the person receiving the money..."

Disaster Recovery Plan

The Company's contingency plan must be current, based on business impact analysis, been tested and addresses all significant business activities, including financial functions, telecommunication services, data processing, network services, and that clearly describe senior management roles and responsibilities associated with the declaration of emergency in accordance with ALA ADMIN CODE 482-1-126-.05(2003), which states:

"Objectives of Information Security Program. A licensee's information security program shall be designed to do all the following:

- (a) Ensure the security and confidentiality of customer information.
- (b) Protect against any anticipated threats or hazards to the security or integrity of the information.

(c) Protect against unauthorized access to or use of the information that could result in substantial harm or inconvenience to any customer.”

Consideration of Fraud

The examiners utilized the procedures recommended in the NAIC Financial Condition Examiners Handbook in Exhibit M – Consideration of Fraud. The examiner interviewed Company management and determined that Company management had an understanding of the fraud risk factors in the company. Company management indicated that the Company investigated one fraud committed by an agent in the State of Tennessee. The State of Tennessee, subsequently suspended the license issued to the agent.

Other than, the fraud policies adopted by the Company, no new procedures were adopted by the Company to avoid similar fraud from happening.

FINANCIAL STATEMENTS

The Financial Statements included in this report were prepared based on the Company's records, and the valuations and determinations made during the examination for the December 31, 2005. Amounts shown in the comparative statements for the years 2002, 2003, and 2004, were compiled from Company copies of filed Annual Statements. The statements are presented in the following order:

Statement of Assets, Liabilities, Surplus	27 and 28
Summary of Operations	29
Capital and Surplus	30

**THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN
THIS REPORT ARE AN INTEGRAL PART THEREOF.**

SOUTHLAND NATIONAL INSURANCE CORPORATION
STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS
For the Year Ended December 31, 2005

	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
ASSETS			
Bonds (Note 1)	\$119,866,137	\$220,041	\$119,646,096
Preferred stocks (Note 2)	5,604,531		5,604,531
Common stocks	43,850		43,850
Mortgage loans on real estate:			
First liens (Note 3)	375,262		375,262
Real estate:			
Properties occupied by the company	187,665		187,665
Cash (\$1,206,243, Sch. E-Part 1), cash equivalents and Short-term investments (\$2,533,038, Sch.) (Note 4)	3,739,281		3,739,281
Contract loans	55,323	-0-	55,323
Subtotals, cash and invested assets	\$129,872,049	\$ 220,041	\$129,652,008
Investment income due and accrued	\$ 1,539,868		\$ 1,539,868
Premiums and considerations:			
Uncollected premiums and agents' balances in course of collection	(1,247,217)		(1,247,217)
Deferred premiums, agents' balances and installments booked but deferred and not yet due (Note 5)	1,298,335		1,298,335
Reinsurance:			
Amounts recoverable from reinsurers	420,141		420,141
Other amounts receivable under reinsurance contracts	204,386		204,386
Net deferred tax asset (Note 6)	5,229,920	4,771,920	458,000
Guaranty funds receivable or on deposit	16,780		16,780
Electronic data processing equipment and software	192,008		192,008
Furniture and equipment, including health care delivery assets	76,206	76,206	
Receivables from parent, subsidiaries & affiliates (Note 7)	2,964		2,964
Health care and other amounts receivable (Note 8)	1,167,972	1,167,972	
Aggregate write-ins for other than invested assets	506,934	483,975	22,959
TOTALS	\$139,280,346	\$6,720,114	\$132,560,232

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN
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SOUTHLAND NATIONAL INSURANCE CORPORATION
STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS
For the Year Ended December 31, 2005

LIABILITIES	
Aggregate reserve for life contracts	\$115,623,671
Aggregate reserve for accident and health contracts (Note 9)	473,998
Contract claims:	
Life	1,142,895
Accident and health	146,516
Premiums and annuity considerations for life and accident and health contracts received in advance	264,905
Contract liabilities not included elsewhere:	
Interest Maintenance Reserve	1,444,259
Commissions to agents due or accrued	1,280
Commissions and expense allowances payable on reinsurance assumed	5,759
General expenses due or accrued	665,282
Taxes, licenses and fees due or accrued, excluding federal income taxes	124,299
Current federal and foreign income taxes	387,242
Unearned investment income	7
Amounts withheld or retained by company as agent or trustee	10,927
Amounts held for agents' account	199,181
Remittances and items not allocated (Note 10)	109,169
Miscellaneous liabilities:	
Asset valuation reserve (Note 11)	196,555
Payable to parent, subsidiaries and affiliates	43,000
Payable for securities	1,001,330
Aggregate write-ins for liabilities	554,595
Total Liabilities	\$122,394,870
CAPITAL AND SURPLUS	
Common capital stock	\$ 1,502,718
Gross paid in and contributed surplus	5,528,042
Unassigned funds (surplus) (Note 12)	3,134,602
Total Surplus	<u>8,662,644</u>
Total Capital and Surplus	\$ <u>10,165,362</u>
<u>TOTAL LIABILITIES, CAPITAL AND SURPLUS</u>	<u>\$132,560,232</u>

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN
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SOUTHLAND NATIONAL INSURANCE CORPORATIONS
SUMMARY OF OPERATIONS
For the Years Ended December 31, 2005, 2004, 2003, and 2002

	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
Income:				
Premiums and annuity consideration	\$ 32,537,662	\$ 37,999,775	\$ 34,348,465	\$ 21,967,969
Net investment income	6,941,451	6,259,293	5,164,910	4,623,000
Amortization of IMR	154,539	159,161	110,462	45,326
Commissions and expense allowances on reinsurance ceded	1,962,545	1,078,666	-0-	-0-
Miscellaneous income	248,317	152,870	81,117	24,291
Total Income	\$ 41,844,514	\$ 45,649,765	\$ 39,704,954	\$ 26,660,586
Deductions:				
Death benefits	\$15,859,539	\$14,543,964	\$10,840,302	\$8,704,247
Matured endowments	0	0	0	3,657
Annuity benefits	70,614	75,962	206,798	142,935
Disability benefits and benefits under accident and health contracts	1,389,036	1,468,116	1,198,449	861,801
Surrender benefits and withdrawals for life contracts	245,320	608,252	535,576	435,660
Interest and adjustments on contract or deposit-type contract funds	3,538	3,885	3,529	3,968
Increase in aggregate reserves for life and accident and health contracts	13,323,435	18,256,741	18,742,552	10,564,388
Commissions on premiums, annuity considerations & deposit-type contract funds(direct business only)	4,883,854	5,424,893	3,153,229	2,261,645
Commissions and expense allowances on reinsurance assumed	21,111	24,803	31,359	22,166
General insurance expenses	4,356,232	4,952,373	3,749,344	2,642,916
Insurance taxes, licenses and fees, excluding federal income taxes	932,331	1,144,506	909,977	638,353
Increase in loading on deferred and uncollected premiums.	88,213	147,217	263,584	91,599
Total deductions	\$41,173,223	\$46,650,712	\$39,634,699	\$26,373,335
Net gain from operations before dividends to policyholders and federal income taxes	\$ 671,291	\$(1,000,947)	\$ 70,255	\$287,251
Net gain from operations after dividends to policyholders and before federal income taxes	671,291	(1,000,947)	70,255	287,251
Federal and foreign income taxes incurred	\$ 326,655	\$ (11,321)	\$ 315,494	\$ (18,702)
Net gain from operations after dividends to policyholders and federal income taxes and before realized capital gains or (losses)	\$344,636	\$(989,626)	\$(245,239)	\$305,953
Net realized capital gains or (losses) less capital gains of \$(21,720) (excluding taxes of \$(106,167) transferred to the IMR)	322,920	(86,884)	(425,466)	(63,881)
Net income	\$ 667,556	\$(1,076,510)	\$ (670,705)	\$ 242,072

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN
THIS REPORT ARE AN INTEGRAL PART THEREOF.

SOUTHLAND NATIONAL INSURANCE CORPORATION
CAPITAL AND SURPLUS ACCOUNT
For the Years Ended December 31, 2005, 2004, 2003, and 2002

	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
Capital and surplus,				
December 31, prior year	<u>\$ 9,439,004</u>	<u>\$ 8,650,000</u>	<u>\$ 7,194,361</u>	<u>\$ 7,553,338</u>
<u>Gains and (losses) in surplus:</u>				
Net income	\$ 667,556	\$ (1,076,510)	\$ (670,705)	\$ 242,072
Change in net unrealized capital gains or (losses) (Note 1)	(1,072,932)	(25,249)	1,176,200	(620,626)
Change in net deferred income tax (Note 6)	4,848,920	(116,000)	(326,936)	216,534
Change in nonadmitted assets and related items (Note 6)	(4,807,773)	(117,739)	(623,822)	(124,161)
Change in asset valuation reserve	592,475	124,502	(627,730)	(71,164)
Surplus adjustment- paid in	-0-	2,000,000	2,638,000	-0-
Surplus adjustment - Transferred to capital (Stock Dividend)			(111,000)	
Aggregate write-ins for gains and losses in surplus	498,112		1,632	(1,632)
Net change in capital and surplus for the year	<u>\$ 726,358</u>	<u>\$ 789,004</u>	<u>\$ 1,455,639</u>	<u>\$ (358,977)</u>
<u>Capital and surplus, December 31, current year</u>	<u>\$10,165,362</u>	<u>\$ 9,439,004</u>	<u>\$ 8,650,000</u>	<u>\$ 7,194,361</u>

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN
THIS REPORT ARE AN INTEGRAL PART THEREOF.

NOTES TO FINANCIAL STATEMENTS

Note 1 – Bonds

\$119,646,096

The captioned amount is \$220,041 less than the \$119,866,137 reported by the Company in its 2005 Annual Statement, and consisted of the following two bonds not admitted for the purpose of this examination:

	Examination changes
Elizabethtown Water Co	\$ 25,098
Northwest Airlines	<u>194,943</u>
	<u>\$ 220,041</u>

Schedule D – Part 1 of the 2005 Annual Statement, reported a public utility bond “Elizabethtown Water Co,” in the amount of \$25,098, acquired on September 17, 1992. The Company did not file a Security Acquisition Report (SAR) in accordance with the guidance provided by PART FOUR, Section 7 of the NAIC Purposes and Procedures Manual of the Security Valuation Office, which states:

"A security issued by an entity unaffiliated with the reporting company is reported by creating, completing and submitting the SAR form. The reporting insurance company must submit the SAR to the SVO not later than 120 days after the purchase of the security..."

Schedule D – Part 1, of the 2005 Annual Statement, reported an industrial bond “Northwest Airlines” in the amount of \$194,943, acquired on January 19, 2000. During the period covered by examination, the security was down graded and the NAIC designation changed from 3FE in 2002 to 5FE in 2005. The NRSRO rating provided by the Company and the SVO did not have a publicly available price for the security as of December 31, 2005. The Company was not in compliance with the guidance provided by PART SIX, section 3(b)(i) of the SVO Purposes and Procedures Manual, which states:

"The reporting insurance company shall provide the SVO with two price quotes for any bond without a publicly available price. The price quotes shall be obtained from financial institutions acceptable to the SVO and shall be written on the letterhead of such financial institutions. The SVO shall use these price quotes to determine a Unit Price for the bond..."

The Company should have not admitted the securities in accordance with ADMIN CODE 482-1-098-.02 (1994), which states:

“(1) All securities owned by an insurer shall be valued in accordance with those standards promulgated by the NAIC Securities Valuation Office. Any security owned by an insurer that has not been valued by the SVO shall be submitted to the SVO for valuation in accordance with the procedures of the SVO....

(3) Any security not valued in accordance with this rule shall be carried as a non-admitted asset on all financial statements of the insurer until such time as the insurer has complied with Paragraph (1) or (2) of this rule.”

The previous examination also recommended that the Company file securities that have not been valued by the SVO in accordance with the guidance provided by the NAIC SVO and comply with ADMIN CODE 482-1-098-.02 (1994).

The examiners reviewed a sample of securities listed on Schedule D – Part 1, in order to establish compliance with the guidance provided by SSAP No.26, paragraph 4 of the NAIC Accounting Practices and Procedures Manual, which states:

“A bond acquisition or disposal shall be recorded on the trade date, not the settlement date, except for the acquisition of private placement bonds which shall be recorded on the funding date. At acquisition, bonds shall be reported at their cost, including brokerage and other related fees, which cannot exceed the fair value at the date of acquisition.”

The examiner determined that five securities from the sample of thirty-two items were recorded on a date that was other than the trade date, which was not in compliance with the aforementioned SSAP.

The Company reported effective yields for loan-backed securities on Schedule D – Part 1 of the 2005 Annual Statement, which were significantly greater, or less than the interest rate reported for that security. Company management could not demonstrate the prepayment speeds and the resulting cash flows of the loan-backed securities were being periodically reviewed as required by SSAP No. 43, Paragraph 11 & 12 of the NAIC Accounting Practices and Procedures Manual, which state:

"11. Changes in currently estimated cash flows, including the effect of prepayment assumptions, on loan-backed securities shall be reviewed periodically. For securities that have the potential for loss of a portion of the

original investment, the review shall be performed at least quarterly. For other securities, the review shall be performed at least annually...

12. The prepayment rates of the underlying loans shall be used to determine prepayment assumptions. Prepayment assumptions shall be applied consistently across portfolios to all securities backed by similar collateral (similar with respect to coupon, issuer, and age of collateral)...Relevant sources and rationale used to determine each prepayment assumption shall be documented by the reporting entity."

The previous examination had also recommended that the Company comply with SSAP No. 43, paragraphs 11 and 12 of the NAIC Accounting Practices and Procedures Manual and review prepayment speeds of loan-backed securities periodically.

Note 2 - Preferred stocks

\$5,604,531

The captioned asset is the same as reported by the Company in its 2005 Annual Statement, but \$256,903 less than that determined by the examination. The Company had inappropriately classified preferred stock in the amount of \$256,903 under bonds. Since it was a reclassifying error, no changes were made to the financial statements.

Schedule D – Part 1, of the 2005 Annual Statement, reported a security "Mellon Cap II Ser B" with an NAIC designation of 1FE. However, according to the SVO CD, the security had an NAIC designation of "RP1," indicating preferred stock. PART THREE, Section 3 of the NAIC Purposes and Procedures Manual, states:

"RP means redeemable preferred and is a valuation indicator that classifies a preferred stock as a redeemable preferred stock pursuant to Part Seven, Section 2(b) of this Manual..."

Note 3 – Mortgage loans

\$375,262

The captioned asset is the same as reported by the Company in its 2005 Annual Statement, but \$41,281 more than that determined by the examination. Due to immateriality, no changes were made to the financial statements.

The examiner reviewed Schedule B – Part 1 of the 2005 Annual Statement and established that one loan with a book value of \$41,281 did not have an appraisal in

the mortgage file. Hence, the examiner could not verify Company's compliance with ALA. CODE § 27-41-29 (1) (1975), which states:

"...no such mortgage loan or loans when made can be 75 percent of the fair value of the real estate or leasehold, except that loans made on single family dwellings shall not exceed 80 percent for the fair value of the property."

Schedule B – Part 1, listed ten mortgage loans as of December 31, 2005. The examiner established the following:

- Eight mortgage loans were serviced by Central Loan Administrative and Reporting (CENLAR) under the old agreement effective December 31, 1986 with, Collateral Mortgage, Ltd., and Southwide Life Insurance Corporation. The examiners asked Company management to provide the sub-contract between Collateral Mortgage, Ltd and CENLAR. Company management did not have the contract between the two parties.
- Wells Fargo serviced two mortgage loans listed on the Company's Annual Statement. The servicing agreement was originally signed by First Mortgage Company, Inc. and New Southland National Life Insurance Company effective December 31, 1969. There was no assumption agreement signed by Wells Fargo after assuming the responsibility of servicing the mortgage loans. The previous examination had recommended that the new parties should sign new contracts or sign an assumption agreement assuming all of the rights and obligations under the agreements.

Since the Company could not provide the servicing agreement (sub-contract) between Collateral Mortgage, Ltd., and CENLAR, the Company did not comply with ALA. CODE § 27-27-29(a)(1975), which states:

"Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its asset, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

The examiners also established that the mortgage files did not contain the appraisals. Since there were no appraisals, the Company did not comply with the aforementioned ALA. CODE § 27-27-29(a)(1975).

Schedule B – Part 1, Column 11, listed the original mortgage loan amount, which did not comply with the NAIC Annual Statement Instructions, which states:

“Value of Land and Buildings – Report the appraisal value of the property (for land and building). For loans subject to participation agreements, include only the reporting entity’s pro rata share of the appraised value as it relates to the reporting entity’s interest in the mortgage loans.”

**Note 4 – Cash, cash equivalents and
short-term investments**

\$3,739,281

The captioned asset is the same as reported by the Company in its 2005 Annual Statement.

At December 31, 2005, the Company had a repurchase agreement with AmSouth Bank. The amount on deposit was \$1,323,000 and reported as cash on *Schedule E - Part 1* instead of short-term investments in *Schedule DA – Part 1*. Since the Company did not report the securities held under the repurchase agreement as short-term investments, it did not comply with the guidance provided by SAP No. 45, paragraph 13, of the NAIC Accounting Practices and Procedures Manual, in pertinent part:

“For the purchaser in dollar repurchase agreement, an asset is recorded for the amount of the purchase. Since the term of the agreement is limited to twelve months, it is accounted for as a short-term investment.”

In addition, the NAIC Annual Statement Instructions, Schedule DA - Part 1, states:

" Include all investments whose maturities (or repurchase dates under repurchase agreement) at the time of acquisition were one year or less except those defined as cash in accordance with SSAP No. 2, Cash, Drafts, and Short-Term Investments..."

SSAP No. 2, paragraph 10, states:

"All investments with remaining maturities (or repurchase dates under repurchase agreements) of one year or less at the time of acquisition (excluding those investments classified as cash equivalents as defined in paragraph 3) shall be considered short-term investments. Short-term investments include, but are not limited to, bonds, commercial paper, money market instruments, repurchase agreements, and collateral and mortgage loans which meet the above criteria..."

The Company made no provisions with AmSouth Bank to obtain collateral with a fair value of at least 102 percent of the purchase price by the Company for the securities. Hence, the Company was not in compliance with SSAP No. 45, Paragraph 8(a) of the NAIC Accounting Practices and Procedures Manual, which states:

"The reporting entity shall receive as collateral transferred securities having a fair value at least equal to 102 percent of the purchase price paid by the reporting entity for the securities. If at anytime the fair value of the collateral is less than 100 percent of the purchase price paid by the reporting entity, the counterparty shall be obligated to provide additional collateral, the fair value of which, together with fair value of all collateral then held in connection with the transaction, at least equals 102 percent of the purchase price."

The examiner established that the Company did not disclose the repurchase agreement in Note 5(E) of the NOTES TO FINANCIAL STATEMENT of the 2005 Annual Statement, which was in conflict with the guidance provided by SSAP 45, paragraph 18 of the NAIC Accounting Practices and Procedures Manual, which states:

"a. If the reporting entity has entered into repurchase agreements, its policy for requiring collateral or other security,

b. A description of the securities underlying the agreements, including book value and fair values, maturities, and weighted average interest rates for the following categories: (i) securities subject to reverse repurchase agreements; (ii) securities subject to repurchase agreements; (iii) securities subject to dollar repurchase agreements; and (iv) securities subject to dollar reverse agreements; and..."

Note 5 - Deferred premiums, agents' balances and
Installments booked but deferred and not yet due **\$1,298,335**

The captioned asset is the same as reported by the Company in its 2005 Annual Statements.

The examiners recomputed the deferred premiums on a sample of items taken from the deferred premium listing. The examiners established that the Company utilized the modal premium due date or dates following the valuation date to the next policy anniversary date to calculate the deferred premiums. However, the deferred premiums collected on policies after the anniversary date were reported as *Premiums and annuity considerations for life and accident and health contracts received in advance* instead of subtracting the same from the deferred premiums. Hence, the Company did not

comply with SSAP No. 51, paragraph 23 of the NAIC Accounting Practices and Procedures Manual, which states:

“Deferred premiums are computed by taking the gross premium (or premiums) extended from (and including) the modal (monthly, quarterly, semiannual) premium due date or dates following the valuation date to the next policy anniversary date and subtracting any such deferred premiums that have actually been collected.”

The Company is required to subtract from the deferred premiums calculated those deferred premiums that have already been collected. The Company does not do so. It records deferred premiums already collected in the advance premium liability.

Note 6 - Net deferred tax asset

\$458,000

The captioned amount is the same as reported by the Company in its 2005 Annual Statement.

The examiners reviewed the accounts and records provided by the Company to support the Net deferred tax assets reported at year-end 2005. The Company had appropriately computed the deferred income tax assets (DTAs) and liabilities (DTLs) based on the expected future tax consequences of temporary differences generated by statutory accounting for the year 2005. The examiners established that the Gross DTA was \$5,229,920, and the Net DTA was \$458,000. The Company did not report the Gross DTA in the “Assets” column of the 2005 Annual Statement; however, the Net DTA in the amount of \$458,000 was report in the “Assets” and the “Net Admitted Assets” columns. The Company did not comply with the guidance provided by SSAP No. 10, paragraphs 10, of the NAIC Accounting Practices and Procedures Manual, which states:

“10. Gross DTA’s shall be admitted in an amount equal to the sum of:

- a. Federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse by the end of the subsequent calendar year...”

The guidance provided by the NAIC Annual Statement Instructions states:

“Assets – Record the amount by category, from the company’s financial records, less any valuation allowance.

Nonadmitted Assets – Include: Amounts for which the state does not allow the company to take credit.

Net Admitted Assets – The amount in Column 3 equals Column 1 minus Column 2...”

Note 7 – Receivable from parent, subsidiaries and affiliates **\$2,964**

The captioned asset is the same as reported by the Company in its 2005 Annual Statement.

The examiners reviewed Schedule Y – Part 2 of the Company Annual Statements under review. The examiner established that the Company had no management agreements, service contracts or cost sharing agreements with Collateral Services, LLC and Collat, Inc. However, a review of related party transactions indicated that the Company paid and received the following fees:

	Paid	Received	Amount
Collateral Services, LLC			
2004	\$ 72,000	\$18,768	\$ 53,232
2005	<u>91,142</u>	<u>16,716</u>	<u>74,426</u>
	<u>\$163,142</u>	<u>\$35,484</u>	<u>\$127,658</u>
Collat, Inc.			
2004	\$ 63,900	\$-0-	\$ 63,900
2005	<u>90,000</u>	<u>-0-</u>	<u>90,000</u>
	<u>\$153,900</u>		<u>\$153,900</u>
	<u>\$317,042</u>	<u>\$35,484</u>	<u>\$281,558</u>

The Company was in violation of ALA. CODE § 27-29-5(b)(1975), which states:

"The following transactions involving a domestic insurer and any person in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such transaction as least 30 days prior thereof...

(4) All management agreements, service contracts, and all cost sharing arrangements...”

Since the Company did not have valid contracts, with Collateral Services, LLC and Collat, Inc., the Company must establish receivables from Collateral Services, LLC for \$127,658 and from Collat, Inc. for \$153,900, and collect the amounts from the affiliates.

Note 8 - Health care and other amounts receivable

\$-0-

The captioned asset is the same as reported by the Company in its 2005 Annual Statement.

The examiners reviewed the Company's accounts and records and determined that the 2005 year-end unsecured receivable from agents was \$1,167,972 (not admitted asset). During 2005, the Company wrote-off \$350,000, which was 23% of the gross unpaid balance of \$1,517,972 (\$1,167,972 + \$350,000) as of December 31, 2005.

The examiner noted that the unsecured agents' debit balance significantly affected the Company's admitted assets, and drained the Company's profitability by way of charges to the summary of operation. The examiners calculation indicated that the \$1,167,972 in agents' unpaid balance was 34.82% of the unassigned funds (surplus) as of December 31, 2005.

Note 9 - Aggregate reserve for accident and health contracts

\$473,998

The captioned amount is the same as reported by the Company in its 2005 Annual Statement, but \$15,061 less than the \$489,059 determined by the examination. Due to immateriality, no changes were made to the 2005 Annual Statements.

The Company assumed reinsurance under a 100% co-insurance agreement from US Able Life Insurance Company. The in-force listing for the travel protection plan provided by the Company was obtained from American Pre-arrangement Service Inc., a third party administrator of the contracts. The examiners utilized ACL and the in-force listing, and established that 49,974 contracts were in-force as of the examination date. According to the terms of the contract, the Company was required to record reserves equal to 100% of statutory reserves. The Company booked *Aggregate reserve for accident and health contracts* based on 48,435, which was 1,539 contracts less than that determined by the examination. SSAP 54, paragraph 10, of the NAIC Accounting Practices and Procedures Manual, states:

"Statutory policy reserve shall be established for all unmatured contractual obligations of the reporting entity arising out of the provisions of the contract. Where separate benefits are included in a contract, a reserve for each benefit shall be established as required in Appendix A-820..."

Note 10 – Remittances and items not allocated

\$199,181

The captioned amount is the same as reported by the Company in its 2005 Annual Statement.

The examiner established that the detailed listing maintained by the Company had an opening balance as of December 31, 2005, which was the closing balance of the prior year. The listing then included all remittances from policyholders placed in suspense accounts during the year 2005. When the amounts placed in the suspense accounts were applied to the premium payments by policyholder, the Company credited the policyholders account and debited the suspense account. The debit was recorded as a negative amount in the suspense account. When the examiners reviewed the accounts balances, the examiner could not identify if the balances were applied to a policyholders account or if the Company had some amounts in suspense that had never been applied to any policyholders' accounts. The examiner requested the Company to provide workpapers showing how the Company cleared the suspense accounts balances subsequent the examination date. The Company did not have documentation to evidence that the account balances were cleared subsequent to the examination date; hence, the Company did not comply with ALA. CODE § 27-27-29(a)(1975), which states:

"Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

Note 11 – Asset valuation reserve

\$196,555

The captioned amount is the same as reported by the Company in its 2005 Annual Statement, but \$11,047 more than the \$185,509 determined by the examination. Due to immateriality, no changes were made to the 2005 Annual Statement.

In *Note 1 – Bonds* under the caption NOTES TO FINANCIAL STATEMENTS, bonds in the amount of \$220,041 was not admitted, because the Company did not comply with the Purposes and Procedures Manual of the NAIC Securities Valuation Office. On recalculation, it was established that the AVR liability decreased by \$11,047. The reclassification of one bond in the amount of \$256,903 to preferred stock did not have any affect on the AVR.

Note 12 – Unassigned funds**\$3,134,602**

The unassigned fund (surplus), as determined by this examination is \$220,041 less than the \$3,354,643 amount reported by the Company in its 2005 Annual Statement.

The following schedule presents a reconciliation of the unassigned funds per the Company's filed statement to that developed by this examination:

Unassigned funds per Company		\$3,354,643
Examination increase /(decrease) to assets:		
• Bonds	\$(220,041)	
Examination (increase) / decrease to liabilities:	\$-0-	
Net increase / (decrease)		<u>\$ (220,041)</u>
Unassigned funds (surplus) per examination		<u>\$ 3,134,602</u>

CONTINGENT LIABILITIES AND PENDING LITIGATION

The review of contingent liabilities and pending litigation included an inspection of representations made by management; a review of the report on litigation made by Company attorneys to the Company's independent certificated public accountants; a review of the report of litigation made by the Company's attorneys to the examiners; and a general review of the Company's records and files conducted during the examination, including a review of Company's claims payments and practices.

During the examination period, a class action lawsuit was filed against the Company and New South Federal Savings Bank (New South). The lawsuit raised the issue of whether the Company has an insurable interest in connection with policies issued by the Company in connection with the customers' purchase of pre-need funeral contracts funded by the Company's life insurance policies issued through or otherwise related to a pre-need funeral trust administered by New South. The examination determined that the policies issued by the Company on the lives of the pre-need funeral contract holders had the owner and the beneficiary other than the person insured. This is a violation of the insurable interest law ALA. CODE 27-14-3(f), which states:

"Any personal insurance contract procured, or caused to be procured, upon another individual is void unless the benefits under the contract are payable to the individual insured, or his or her personal representative, or to a person having, at the time when the contract was made, an insurable interest in the individual insured. In the case of a void contract, the insurer shall not be liable on the contract but shall be liable to repay to the person, or persons, who have paid the premiums, all premium payments without interest."

The trust is not one of the exceptions stated in the law as having an insurable interest in the life of an insured. The Company has also accepted pre-need business from funeral homes and cemeteries on which those funeral homes and cemeteries have purchased life insurance from the Company on the lives of pre-need purchasers. A funeral home or cemetery is not one of the exceptions stated in the law as having an insurable interest in the life of an insured. This is a violation of the insurable interest law ALA. CODE 27-14-3(f). Because of this violation of the insurable interest law, there is a potential contingent liability.

The Company should not accept pre-need business from the funeral trust administrated by New South in which the funeral trust has purchased insurance on the life of any pre-need purchaser since currently the trust has no insurable interest in the life of any pre-need purchaser. The Company should also not accept pre-need business in which a funeral home or cemetery has purchased life insurance on the life of any pre-need purchaser since currently a funeral home or cemetery has no insurable interest in the life of any pre-need purchaser.

The Company also had one significant non-policy related lawsuit at December 31, 2005. Company management indicated that it would vigorously contest the claim, which is now in the discovery stages.

COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

A review was conducted during the current examination with regard to the Company's compliance with recommendations made in the previous examination report. This review indicated that the Company had satisfactorily complied with the recommendations contained in the immediately preceding Report of the Examination with the exception of the items listed below.

The preceding report of examination recommended that the Company not enter into any transactions with persons in its holding company system unless the insurer has notified the commissioner in writing of its intention to enter into such transactions. It is recommended that the Company file all related parties contracts with the

commissioner for approval before entering into transactions under the contract and comply with ALA CODE 27-29-5 (b)(1975), which states:

"The following transactions involving a domestic insurer and any persons in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such transactions at least 30 days prior thereto...

(4) All management agreements, services contracts, and all cost sharing arrangements."

The preceding report of examination recommended that the Company comply with ALA. ADMIN. CODE 482-1-098-.02(1994) and have all securities owned by the insurer valued by the Securities Valuation Office or non-admit the securities on all financial statements. **It is recommended** that the Company have all securities valued according to the guidance provided by the NAIC Purposes and Procedures Manual of the Securities Valuation Office and comply with ADMIN CODE 482-1-098-.02(1994), which states:

"(1) All securities owned by an insurer shall be valued in accordance with those standards promulgated by the NAIC Securities Valuation Office... (3) Any security not valued in accordance with this rule shall be carried as a non-admitted asset on all financial statements of the insurer until such time as the insurer has complied with Paragraph (1) or (2) of this rule."

The preceding report of examination recommended that the Company periodically review the changes in payment assumption and the resulting cash flows and comply with SSAP No. 43. **It is recommended** that the Company maintain evidence that it was monitoring the loan-backed securities in its portfolio in accordance with the guidance provided by SSAP No. 43, paragraphs 11 and 12, of the NAIC Accounting Practices and Procedures Manual, which states:

"Changes in currently estimated cash flows, including the effect of prepayment assumptions, on loan-backed securities shall be reviewed periodically. For securities that have the potential for loss of a portion of the original investment, the review shall be performed at least quarterly. For other securities, the review shall be performed at least annually..."

The preceding report of examination recommended that the Company either have the new parties to the mortgage servicing sign assumption agreement assuming all the rights and obligations under the agreements or have all the parties involved sign new

mortgage servicing agreements. **It is recommended** that the Company either have the new parties to the mortgage servicing agreement sign assumption agreements or have the parties involved sign new mortgage servicing agreements.

SUBSEQUENT EVENTS

The examiners reviewed the general ledger, and cash transactions occurring subsequent to the balance sheet date. In addition, the examiners inquired of management regarding any significant subsequent events. There were no significant events noted other than those listed below:

The name of Collateral Mortgage, Ltd. was changed to Collateral Holding, Ltd. effective January 1, 2006.

COMMENTS AND RECOMMENDATIONS

Stockholder – Page 5

It is recommended that the Company issue a share certificate to its sole shareholder and comply with ALA. CODE § 10-2B-6.25(1975), which states:

"(a) Shares shall be represented by certificates. (b) At a minimum each share certificate must state on its face: (1) The name of the issuing corporation and that it is organized under the law of this state; (2) The name of the person to whom issued; and (3) The number and class of shares and the designation of the series, if any, the certificate represents..."

It is recommended that the Company's corporate records include the minutes of the stockholders meetings as required by ARTICLE I, Section 2, of the By-Laws, which states:

"The Annual Meeting of the stockholders of said Company shall be held at Tuscaloosa, Alabama, on a date to be set by the Board of Directors each year for the purpose of electing Directors and receiving reports from the old Board and officers..."

ALA. CODE § 27-27-23(1975), which states:

"Directors must be elected by the member or stockholders of a domestic insurer at the annual meeting of stockholders or members..."

ALA. CODE § 10-2B-7.01(a) (1975) states:

"A corporation shall hold a meeting of shareholders annually at a time stated or fixed in accordance with the bylaws."

Board of Directors - Page 6

It is recommended that the investment transactions made by the Company must be authorized, approved or ratified by the Board of Directors as required by ALA CODE § 27-41-5, which states:

"An insurer shall not make any investment or loan, other than loans on policies or annuity contracts, unless the same be authorized, approved or ratified by the board of directors of the insurer or by such committee or person as the board of directors shall expressly authorize. The action of the board of directors, the committee or other persons so authorized shall be recorded and regular reports thereof shall be submitted to the board of directors...."

It is recommended that the Company keep permanent records of all actions taken by the Shareholders and Board of Directors, including capital contribution made by Collateral Investment Corporation, in accordance with ALA. CODE § 10-2B-16.01(1975), which states:

"A corporation shall keep as permanent records minutes of all meetings of its shareholders and board of directors, a record of all actions taken by the shareholders or board of directors without a meeting, and a record of all actions taken by a committee of the board of directors in place of the board of directors on behalf of the corporation."

Conflict of Interest - Page 7

It is recommended that the Company maintain evidence of its Conflict of Interest statements signed annually by each officer, director and other key personnel according to the GENERAL INTERROGATORIES of the NAIC Annual Statement Instructions and the Company's Conflict of Interest Policy.

Holding Company Registration and Reporting - Page 8

It is recommended that the Company file all related parties' contracts with the commissioner for approval before entering into transactions under the contract and comply with ALA. CODE § 27-29-5(b), which states:

"The following transactions involving a domestic insurer and any persons in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such transaction at least 30 days prior thereto...

(4) All management agreements, services contracts, and all cost sharing arrangements."

Dividend to Stockholders - Page 9

It is recommended that all dividends paid by the Company, including stock dividends, be reported to the commissioner on a Form B filing in accordance with ALA. CODE § 27-29-5 (g) (2)(1975), which states:

"A domestic insurer subject to registration under Section 27-29-4 shall report to the commissioner all dividends to shareholders within five business days following the declaration of the dividends and not less than 10 days prior to the payment of the dividends. This report shall also include a schedule setting forth all dividends or other distributions made within the previous 12 months."

Policy Forms, Rates and Underwriting Practices - Page 16

It is recommended that the Company follow the provisions of its policy and, unless a different option is selected by the insured and documented by the Company, provide extended term insurance in the case of a lapse of policies.

It is recommended that the Company contact the policyholders who were incorrectly converted to a reduced paid-up policy instead of an extended term policy and allow the insured to revert back to the default non-forfeiture option, if desired by the policyholder.

Reinsurance - Page 19

It is recommended that the Company cease conducting business with US Able and with American Pre-Arrangement Services Inc. as relates to accepting any new business after the effective date of termination.

It is recommended that the Company maintain complete records of all transactions including, but not limited to executed copies of all reinsurance treaties, TPA agreements, and memorandums of understanding.

It is recommended that the Company comply with the terms of executed agreements in its possession, including but not limited to, paying only amounts specified by contract.

It is recommended that the Company comply with Alabama laws and/or regulations relating to reinsurance agreements and comply with the terms of those reinsurance agreements, including the provision that there not be side agreements relating to these reinsurance agreements.

It is recommended that the Company not enter into fronting type arrangements, particularly where there might be questions as to whether the Company is authorized to write or reinsure the product.

It is recommended that the Company develop and institute a program to verify changes in the residence of insureds and to develop a system to update its in-force records for those insureds that have died, but did not have a claim under this program.

It is recommended that the Company maintain complete records of the assumed reinsurance transactions so the examiners can verify the accuracy of the contract in-force, premium receipts, claims settlement, and comply with ALA. CODE § 27-27-29(a)(1975), which states:

“Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its asset, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind or kinds, of insurance transacted.”

It is recommended that the Company complete *Schedule S – Part 3 – Section 1* in accordance with the NAIC Annual Statement Instructions and utilize the appropriate abbreviations to identify the plan and type of insurance in *Schedule S – Part 3 – Section 1*, which states:

"Column 6 - Type - Use the following abbreviations to identify the plan and type of reinsurance. For example, group coinsurance with funds withheld should be identified as COFW/G (If there is more than one type of reinsurance in the same reinsurance company, show each type on a separate line.) The type should be entered in all capital letters, and ALL reinsurance

type should be followed by /G (for Group) or/I (for Individuals...
Abbreviations: Individuals - I; Group - G; Catastrophe - CAT; Yearly
renewable term - YRT; Coinsurance - CO..."

It is recommended that the Company maintain the reinsurance underwriting files in accordance with ALA. CODE § 27-27-29(a)(1975), which states:

"Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its asset, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind or kinds, of insurance transacted."

It is noted that Michael Tucker, FSA, MAAA with Wakely Actuarial Services, Inc. prepared the coinsurance agreement relating to this fronting arrangement. Wakely Actuarial Services, Inc. prepared and submitted the group global accident and sickness policy with the State of Alabama, on behalf of US Able. Michael Tucker signed the actuarial opinions for Southland National Insurance Corporation during the period covered by this examination. In addition, the Company has a coinsurance agreement, discussed under the next caption with Southern Financial Life Insurance Company, a related party to Wakely Actuarial Services, Inc.

Accounts and Records – Page 24

It is recommended that the Company maintain individual check vouchers describing all services and itemizing all expenditures for disbursements of \$25 or more, to be in compliance with ALA CODE § 27-27-30 (1975), which states:

"No insurer shall make any disbursement of \$25.00 or more unless evidenced by a voucher or other document correctly describing the consideration for the payment and support by a check or receipts or receipt endorsed or signed by, or on behalf of, the person receiving the money..."

It is recommended that the Company implement an written contingency plan that clearly describes senior management roles and responsibilities associated with the declaration of emergency in accordance with ALA ADMIN CODE 482-1-126-.05(2003), which requires the following:

"Objectives of Information Security Program. A licensee's information security program shall be designed to do all the following:

- (a) Ensure the security and confidentiality of customer information.

(b) Protect against any anticipated threats or hazards to the security or integrity of the information.

(c) Protect against unauthorized access to or use of the information that could result in substantial harm or inconvenience to any customer. "

Bonds - Page 31

It is recommended that the Company file Security Acquisition Reports for bonds, which are not listed on the filing exempt listing in accordance with the guidance provided by PART FIVE, Section 7 of the NAIC Purposes and Procedures Manual of the Securities Valuation Office, which states:

"A security issued by an entity unaffiliated with the reporting company is reported by creating, completing and submitting the SAR form. The reporting insurance company must submit the SAR to the SVO not later than 120 days after the purchase of the security..."

It is recommended that the Company review the securities without publicly available price and file the securities with the SVO in accordance with the guidance provided by PART SIX, section 3(b)(i) of the SVO Purposes and Procedures Manual, which states:

"The reporting insurance company shall provide the SVO with two price quotes for any bond without a publicly available price. The price quotes shall be obtained from financial institutions acceptable to the SVO and shall be written on the letterhead of such financial institutions. The SVO shall use these price quotes to determine a Unit Price for the bond..."

It is recommended that all securities owned by the insurer be valued by the SVO. The insurer shall not admit securities that are not valued in accordance with the SVO and comply with ADMIN CODE 482-1-098-.02 (1994) states:

"(1) All securities owned by an insurer shall be valued in accordance with those standards promulgated by the NAIC Securities Valuation Office. Any security owned by an insurer that has not been valued by the SVO shall be submitted to the SVO for valuation in accordance with the procedures of the SVO..."

(3) Any security not valued in accordance with this rule shall be carried as a non-admitted asset on all financial statements of the insurer until such time as the insurer has complied with Paragraph (1) or (2) of this rule."

It is recommended that the Company record the acquisition or disposal of securities on the trade date in accordance with the guidance provided SSAP No 26, paragraph 4, of the NAIC Accounting Practices and Procedures Manual, which states:

"A bond acquisition or disposal shall be recorded on the trade date, not the settlement date, except for the acquisition of private placement bonds which shall be recorded on the funding date. At acquisition, bonds shall be reported at their cost, including brokerage and other related fees, which cannot exceed the fair value at the date of acquisition."

It is recommended that the Company maintain evidence that it was monitoring the loan-backed securities in its portfolio in accordance with the guidance provided by SSAP No. 43, paragraphs 11 and 12, of the NAIC Accounting Practices and Procedures Manual, which states:

"11. Changes in currently estimated cash flows, including the effect of prepayment assumptions, on loan-backed securities shall be reviewed periodically. For securities that have the potential for loss of a portion of the original investment, the review shall be performed at least quarterly. For other securities, the review shall be performed at least annually..."

12. The prepayment rates of the underlying loans shall be used to determine prepayment assumptions. Prepayment assumptions shall be applied consistently across portfolios to all securities backed by similar collateral (similar with respect to coupon, issuer, and age of collateral)...Relevant sources and rationale used to determine each prepayment assumption shall be documented by the reporting entity."

Preferred stocks – Page 33

It is recommended that the Company classify securities with "RP" symbol before the designation as preferred stock in accordance with the guidance provided by PART THREE, Section 3 of the NAIC Purposes and Procedures Manual, states:

"RP means redeemable preferred and is a valuation indicator that classifies a preferred stock as a redeemable preferred stock pursuant to Part Seven, Section 2(b) of this Manual..."

Mortgage loans – Page 33

It is recommended that the Company document the appraisals and reevaluate its mortgage loans to comply with ALA. CODE § 27-41-29 (1) (1975), which states:

"...no such mortgage loan or loans when made can be 75 percent of the fair value of the real estate or leasehold, except that loans made on single family dwellings shall not exceed 80 percent for the fair value of the property."

It is recommended that the Company either have the new parties to the mortgage servicing agreement sign assumption agreements assuming all the rights and obligations under the agreements or have all the parties involved sign new mortgage servicing agreements. A similar recommendation was made in the prior examination.

It is recommended that the Company maintain the copy of the appraisals on which the mortgage loans were originally made in accordance with ALA. CODE § 27-27-29(a)(1975).

"Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its asset, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

It is recommended that the Company obtain the sub-contract between Collateral Mortgage, Ltd., and Central Loan Administrative and Reporting (CENLAR) and comply with the aforementioned ALA. CODE § 27-27-29(a)(1975).

It is recommended that the Company complete Schedule B – Part 1, Column 11, in accordance with the NAIC Annual Statement Instructions, which states:

"Value of Land and Buildings – Report the appraisal value of the property (for land and building). For loans subject to participation agreements, include only the reporting entity's pro rata share of the appraised value as it relates to the reporting entity's interest in the mortgage loans."

Cash and short-term investments – Page 35

It is recommended that the Company report the repurchase transactions as short-term investments as required by the NAIC Annual Statement Instructions and SSAP

No. 45, paragraph 13, of the NAIC Accounting Practices and Procedures Manual, in pertinent part:

“For the purchaser in dollar repurchase agreement, an asset is recorded for the amount of the purchase. Since the term of the agreement is limited to twelve months, it is accounted for as a short-term investment.”

and SSAP No. 2, paragraph 10, Accounting Practices and Procedures Manual, which states:

"All investments with remaining maturities (or repurchase dates under repurchase agreements) of one year or less at the time of acquisition... shall be considered short-term investments. Short-term investments include, but are not limited to, bonds, commercial paper, money market instruments, repurchase agreements..."

It is recommended that the Company ensure the collateral pledged for the repurchase agreement equals at least 102 percent of the purchase price of the underlying security in accordance with SSAP No. 45, Paragraph 8(a) of the NAIC Accounting Practices and Procedures Manual, which states:

"The reporting entity shall receive as collateral transferred securities having a fair value at least equal to 102 percent of the purchase price paid by the reporting entity for the securities..."

It is recommended that the Company accurately disclose the securities subject to repurchase agreement in Note 5(E) of the NOTES TO FINANCIAL STATEMENT as required by SSAP 45, paragraph 18 of the NAIC Accounting Practices and Procedures Manual, which states:

“a. If the reporting entity has entered into repurchase agreements, its policy for requiring collateral or other security,

b. A description of the securities underlying the agreements, including book value and fair values, maturities, and weighted average interest rates for the following categories: (i) securities subject to reverse repurchase agreements; (ii) securities subject to repurchase agreements; (iii) securities subject to dollar repurchase agreements; and (iv) securities subject to dollar reverse agreements..."

Deferred premiums, agents balances, and installments booked but deferred and not yet due – Page 36

It is recommended that the Company report the deferred premiums in accordance with the guidance provided by SSAP No. 51, paragraph 23 of the NAIC Accounting Practices and Procedures Manual, which states:

“Deferred premiums are computed by taking the gross premium (or premiums) extended from (and including) the modal (monthly, quarterly, semiannual) premium due date or dates following the valuation date to the next policy anniversary date and subtracting any such deferred premiums that have actually been collected.”

Net deferred tax asset – Page 37

It is recommended that the Company report the gross DTA under “Assets” and complete the balance sheet in accordance with the guidance provided by the NAIC Annual Statement Instructions, which states:

“Assets – Record the amount by category, from the company’s financial records, less any valuation allowance.

Nonadmitted Assets – Include: Amounts for which the state does not allow the company to take credit.

Net Admitted Assets – The amount in Column 3 equals Column 1 minus Column 2...”

Receivable from parent, subsidiaries and affiliates – Page 38

It is recommended that the Company not enter into any transactions with affiliated companies without the prior approval of the service agreements by the commissioner of insurance as required by ALA. CODE § 27-29-5(b)(1975), which states:

“The following transactions involving a domestic insurer and any person in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such transaction as least 30 days prior thereof...

(4) All management agreements, service contracts, and all cost sharing arrangements...”

It is recommended that the Company collect the amount paid to Collateral Services, LLC in the amount of \$127,658 and Collat, Inc. in the amount of \$153,900 without valid contracts.

Health Care other amount receivable - Page 39

It is recommended that the Company evaluate its policy and procedure for granting advances to agents. The allowance for doubtful debt was a significant drain on the Company's net income as of December 31, 2005.

Aggregate reserve for accident and health contracts - Page 39

It is recommended that the Company maintain complete and accurate records of its A & H in-force contracts and establish reserves for all unmatured contractual agreements in accordance with SSAP 54, paragraph 10, of the NAIC Accounting Practices and Procedures Manual, states:

"Statutory policy reserve shall be established for all unmatured contractual obligations of the reporting entity arising out of the provisions of the contract. Where separate benefits are included in a contract, a reserve for each benefit shall be established as required in Appendix A-820..."

Remittances and items not allocated - Page 39

It is recommended that the Company maintain complete records showing how the account balances kept in suspense accounts are cleared when they are applied to the appropriate accounts and comply with ALA. CODE § 27-27-29(a)(1975), which states:

"Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

Contingent Liabilities and Pending Litigation - Page 41

It is recommended that the Company not write any life insurance on the life of any pre-need purchaser where the applicant for the insurance is anyone who does not have any insurable interest in the life of the pre-need purchaser as specified in ALA. CODE § 27-14-3(f)(1975). This also applies to the trust managed by New South Federal Savings Bank. ALA. CODE § 27-14-3(f)(1975) states:

"Any personal insurance contract procured, or caused to be procured, upon another individual is void unless the benefits under the contract are payable to the individual insured, or his or her personal representative, or to a person having, at the time when the contract was made, an insurable interest in the

individual insured. In the case of a void contract, the insurer shall not be liable on the contract but shall be liable to repay to the person, or persons, who have paid the premiums, all premium payments without interest."

CONCLUSION

In concluding this Report on Examination, as of December 31, 2005, of *SOUTHLAND NATIONAL INSURANCE CORPORATION*, acknowledgment is hereby made of the courtesy and cooperation extended by all persons representing the Company during the course of the examination.

The customary examination procedures, as recommended by the National Association of Insurance Commissioners, have been followed to the extent appropriate in connection with the verification and valuation of assets and the determination of liabilities set forth in this report.

In addition to the undersigned, Theo Goodin, Robert Thompson, Jerry Hyche, Examiners, and Harland Dyer, ASA, MAAA, FCA, Consulting Actuarial Examiner, all representing the Alabama Department of Insurance, participated in this examination of Southland National Insurance Corporation.

Respectfully submitted,



Blase Francis Abreo, CFE

Examiner-in-Charge

State of Alabama

Department of Insurance